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Department of the Treasury
Washington, DC 20224

Third Party Communication: None
Date of Communication: Not Applicable

Person To Contact: _____, ID No. _____

Telephone Number:

Refer Reply To:
CC:PSI:B02
PLR-117907-10

Date:
May 28, 2010

Legend

$$\underline{X} =$$
A =

Spouse =

Trust =

Marital Trust =

Family Trust =

State =

D1 =

D2 =D3 =D4 =

Dear :

This responds to a letter dated April 23, 2010 submitted on behalf of X by X's authorized representative, requesting inadvertent termination relief pursuant to § 1362(f) of the Internal Revenue Code.

The information submitted states that X was incorporated under the laws of State and elected to be an S corporation effective D1. Trust, a trust that was treated (under subpart E of part I of subchapter J of chapter 1 of the Code ("subpart E") as entirely owned by A, was a shareholder of X. On D2, A died. Upon A's death, Trust ceased to qualify as a grantor trust with respect to A.

Trust provided that following A's death, the Family Trust be funded with a portion of the trust assets, and a marital trust be funded with the remaining assets. The Marital Trust provided that Spouse had the power to request a distribution of all the assets from the trust. The Family Trust and Marital Trust were funded on D4 with X stock. X represents that Family Trust was eligible to be an electing small business trust (ESBT) within the meaning of § 1361(e) effective D4. However, no election to be to an ESBT was filed on behalf of Family Trust. Therefore, the Family Trust was not a permissible shareholder, and X's S corporation election was terminated effective D4.

X represents that the circumstances resulting in the ineffectiveness of X's S corporation election and the failure to file an ESBT election for the Family Trust was inadvertent and were not motivated by tax avoidance or retroactive tax planning. Additionally, X represents that X has filed federal income tax returns consistent with having a valid S corporation election in effect for X beginning on D1. X and its shareholders have agreed to make such adjustments (consistent with the treatment of X as an S corporation) as may be required by the Secretary.

Section 1361(a)(1) defines an "S corporation" as a small business corporation for which an election under § 1362(a) is in effect for the taxable year.

Section 1361(b)(1)(B) provides that the term small business corporation is a domestic corporation which is not an ineligible corporation and which does not have as a shareholder a person (other than an estate and other than a trust described in § 1361(c)(2) or an organization described in § 1361(c)(6)) who is not an individual.

Section 1361(c)(2)(A)(i) provides that for purposes of § 1361(b)(1)(B), a trust all of which is treated (under subpart E) as owned by an individual who is a citizen or resident of the United States may be a shareholder.

Section 1362(c)(2)(A)(ii) provides that a trust which was described in § 1361(c)(2)(A)(i) immediately before the death of the deemed owner and which continues in existence after such death, but only for the 2-year period beginning on the day of the deemed

owner's death may be a shareholder.

Section 678(a)(1) provides that a person other than the grantor shall be treated as the owner of any portion of a trust with respect to which such person has a power exercisable solely by himself to vest the corpus or the income therefrom in himself.

Section 1362(f) provides that if (1) an election under § 1362(a) by any corporation (A) was not effective for the taxable year for which made (determined without regard to § 1362(b)(2)) by reason of a failure to meet the requirements of § 1361(b) or to obtain shareholder consents, or (B) was terminated under paragraph (2) or (3) of § 1362(d); (2) the Secretary determines that the circumstances resulting in such ineffectiveness or termination were inadvertent, (3) no later than a reasonable period of time after discovery of the event resulting in the ineffectiveness, steps were taken (A) so that the corporation is a small business corporation, or (B) to acquire the required shareholder consents, and (4) the corporation, and each person who was a shareholder of the corporation at any time during the period specified pursuant to § 1362(f), agrees to make such adjustments (consistent with the treatment of the corporation as an S corporation) as may be required by the Secretary with respect to such period, then, notwithstanding the circumstances resulting in such ineffectiveness, the corporation shall be treated as an S corporation during the period specified by the Secretary.

Based solely on the information submitted and the representations made, we conclude that Trust was a permissible S shareholder under § 1361(c)(2)(A)(ii) beginning the date of A's death and ending on D3, the day before the Family Trust and Marital Trust were funded. The power granted to Spouse to withdraw all assets contributed to the Marital Trust, including the X stock, results in Spouse being treated as the owner of the Marital Trust beginning D4, the date the Marital Trust was funded, under § 678(a)(1).

Accordingly, Marital Trust is a permitted shareholder of X under § 1361(c)(2)(A)(i).

In addition, we conclude that X's S corporation election was inadvertently terminated on D4 because Family Trust was an ineligible shareholder. Therefore, pursuant to the provisions of § 1362(f), X will be treated as an S corporation from D1 and thereafter provided that (i) the Family Trust files a ESBT election effective D4, pursuant to the procedures set forth in § 1.1361-1(m)(2), with the appropriate service center within 60 days of the date of this letter, (ii) Marital Trust, Spouse, and Family Trust and its beneficiaries will file amended returns for tax years including D4 and subsequent taxable year consistent with the treatment of the Family Trust as an ESBT and the Marital Trust as a grantor trust entirely owned by Spouse within 60 days of the date of this letter, and (iii) provided that X's election to be an S corporation was not otherwise ineffective and was not terminated under § 1362(d). A copy of this letter should be attached to the ESBT election.

Except for the specific ruling above, no opinion is expressed or implied concerning the federal tax consequences of the facts of this case under any other provision of the

Code. Specifically, no opinion is expressed or implied regarding X's eligibility to be an S corporation or Family Trust's eligibility to be an ESBT.

This ruling is directed only to the taxpayer who requested it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

Pursuant to a power of attorney on file with this office, a copy of this letter is being forwarded to X's authorized representative.

Sincerely,

Bradford R. Poston
Acting Branch Chief, Branch 2
(Passthroughs & Special Industries)

Enclosures (2)

Copy of this letter

Copy for section 6110 purposes